IN THE MATTER OF THE *UTILITIES COMMISSION ACT*
R.S.B.C. 1996, as amended
and the
INSURANCE CORPORATION ACT
R.S.B.C 1996, as amended

IN THE MATTER OF AN APPLICATION BY THE
INSURANCE CORPORATION OF BRITISH COLUMBIA
FOR APPROVAL OF 2004 REVENUE REQUIREMENTS FOR
UNIVERSAL COMPULSORY AUTOMOBILE INSURANCE

REPLY SUBMISSIONS ON BEHALF OF INSURANCE CORPORATION OF BRITISH COLUMBIA

INTRODUCTION

These reply submissions on behalf of the Insurance Corporation of British Columbia ("ICBC" or "the Corporation") respond to the submissions of Intervenors. This reply does not repeat the initial submissions of ICBC and, as many issues have already been addressed in ICBC's initial submissions, the lack of a response to a point raised by an Intervenor should not be taken as agreement by ICBC. This reply is organized topically, as some Intervenors addressed similar issues.

As mentioned in a number of Intervenor submissions, the regulatory process is new for ICBC and for some Intervenors. The regulatory model applicable to public utilities cannot be directly transferred to ICBC. In an insurance business, actuarial evidence plays a key role in setting rates and incorporates an estimate of claims costs which are payable in the future but must be recognized as a cost of the year for which rates are being set.

This proceeding has been affected by lack of familiarity with BCUC's regulatory process, lack of familiarity with ICBC and the insurance industry, and further by the expedited process required by the necessity of a decision by mid November. As parties become more familiar with the process, and as ICBC transitions to a regulated environment, the Corporation will be better able to support

future revenue requirements and address information requests on issues relevant to the basic insurance business.

Pemberton Insurance Corporation ("Pemberton") suggests on page 15 of its Submission that "...BC Utilities Commission take the first year of regulatory review as an opportunity to take position, and to support and advocate the prudent course of action" and at page 7 that "the BC Utilities Commission is the proxy to represent the customer". ICBC agrees with the principle of following a prudent course of action, and has made this Application with prudency in mind. However, ICBC submits that the role of the Commission is that of an independent regulator; it is not the role of the Commission to take positions but rather to balance the interests of all participants in the proceeding.

RATE REQUEST

As set out in the covering letter to the Application and ICBC's Submission dated October 10, the Application seeks a rate increase of 0.4% for an increase in premium taxes and 0.9% for an increase in the tariff used to compute legal costs for indemnification of successful litigants, both of which are beyond the control of ICBC. It is worthy of note that in the Submissions of Intervenors there is little discussion of these two items. Intervenors, particularly those knowledgeable in matters relating to insurance, have not taken issue with the need for a rate increase to cover these cost increases. Pemberton recognized the reality of these costs increases when at page 14 of its Submission it stated:

> "Although the 1.3% requested increase for 2004 revenues is simply explained by two direct, expected, and predictable costs being the increase in premium taxes and supreme court tariffs, it does not rationalize why the Independent Actuary recommended 3% increase has not been applied for."

The October 17 Submission of the OPEIU referred back to its October 3 letter where it said: "The increased tax level on premiums from 4% to 4.4% and resulting 0.4% increase is unavoidable in our view...". In its October 3 letter the OPEIU suggested that the increase for legal tariffs was premature. For the reasons given at pages 4 and 5 of its initial Submission, ICBC submits that the increase in Court tariffs must be recognized in 2004 rates for basic insurance.

In the quotation above, Pemberton highlights the fact that ICBC is not requesting the increase recommended by its Independent Actuary and instead is requesting a rate

increase of only 1.3%. Family Insurance at page 4 of the "Supporting Arguments" attached to its September 19 information request submitted that ICBC should request the actuarially required increase for policy year 2004. A similar statement is also found in the Submission of the Insurance Bureau of Canada ("IBC"):

> "If ICBC was, in fact, explicitly following Eckler's recommendations, this might provide the Commission and the public with a greater degree of comfort."

If an increase of 3% would provide IBC, the Commission, and the public, with comfort then the proposed increase of 1.3%, which is below inflation, certainly is not excessive. The requested increase allows ICBC to meet the legislated requirement of $36 million net income for basic insurance for 2004. Requesting the indicated actuarial rate requirement of 3% would result in a 2004 net income which exceeds the target.

It is ICBC's intent that future rate applications will be based upon actuarial practices for determining rate level requirements. This will allow ICBC to manage the basic business, such that policyholders enjoy a rate environment where rates will be smoother and more stable over time. Income generated by the basic business will be used to strengthen retained earnings for the benefit of customers.

GOVERNMENT POLICY

A number of Intervenors have made statements as to the intent of government in establishing the regulatory framework for ICBC. The government's Core Services Review of ICBC resulted in the decision to move ICBC under the authority of an independent, arm's length regulatory body and changes were made through the *Insurance Corporation Amendment Act* ("*ICAA*") to establish the Commission as ICBC's regulator. The legislation provides the Lieutenant Governor in Council ("LGIC") with the ability to establish financial outcome targets for the Corporation, including targets for capital base and profits. For 2004, a net income target of $36 million was established for the basic business through *Special Direction IC1*.

In its Submission IBC says that it is an explicitly stated policy goal of the government to adversely affect ICBC's competitive optional business. The policies of government which the Commission is to follow are those set out in enacted legislation, including *Special Direction IC1*. Nothing in the legislation supports the

position advanced by IBC. Subsection 2(3) of the *Special Direction* expressly states that:

> "With respect to the exercise of its powers and functions under the Act in relation to the corporation, the commission must not fix rates applicable to optional automobile insurance".

The *ICAA* specifically makes reference to the exclusion of optional rates under subsection 44 (6), which states:

> "Section 62 of the *Utilities Commission Act* [which refers to filed rate schedules] does not apply to rates for optional automobile insurance."

The legislation grants the Commission jurisdiction over universal compulsory automobile (or basic) insurance; the legislation excludes the Commission from a role in setting rates for optional insurance and there is nothing in the legislation that suggests that the Commission should adversely affect ICBC's optional insurance business.

On page 7 Pemberton questions the role of government in operating an insurance business and states that the rationale for government operation lacks merit. The issue of government's role in auto insurance was examined as part of the Core Services Review process. The outcome of the process confirmed ICBC as the sole provider of universal compulsory automobile insurance. This proceeding is to establish rates for basic insurance for ICBC, not to debate the merits of government ownership of insurance companies.

PROFIT AND CAPITAL REQUIREMENT

At various places in its Submission Pemberton says that the mandate for basic insurance is to operate without a profit. In support of its position Pemberton cites advertising by a political party in 1972. Notwithstanding what might have been said in past political campaigns, the requirement set by *Special Direction IC1* is that in setting rates for basic insurance, the Commission must take into account a net income target for the Corporation for 2004 of $36 million and without any contribution from optional coverages. The legislative requirement is that basic insurance be operated on a profitable basis.

Since insurance premiums and losses occur over more than one calendar year the usual method of determining rate adequacy is the actuarial method which ICBC

intends to apply in subsequent years. If ICBC had requested the actuarial indicated 3% increase, the mandated $36 million net income target would have been surpassed.

Pemberton suggests on page 10 that in setting rates for basic insurance ICBC can take into account past losses or profits by adjusting future rates (a retroactive perspective). This suggestion is incorrect. For 2004 and into the future rates for basic insurance will be set by the Commission, and setting rates to take account of past profits or losses is not a generally accepted method of regulation. Furthermore, the suggestion of Pemberton is contrary to rate setting within the insurance business, which determines rates on a prospective basis. Customers paying insurance premiums in a policy year should benefit from the coverage related to that policy year. Factoring in past losses and profits would result in a transfer of costs and benefits from one policy year to policyholders paying premiums in a future policy year. This would lead to greater volatility of rates and potential rate shock for customers.

Pemberton further argues that ICBC's basic business should be run as a pool of funds matching premium inflows with claim and expense outflows, without the need for capital. Following the logic of this statement, one could conclude that Pemberton is advocating that existing retained earnings be allocated to the optional business as it suggests there is no need for capital within the basic business.

Pemberton also discusses the need for ICBC's optional business to be fully capitalized to regulatory standards. ICBC agrees that capital is required, and submits that it is required for both the basic and optional business. In an insurance business, the adequacy of capital is a key indicator of overall solvency, and provides ICBC and other insurers with the ability to absorb unexpected losses arising from unusual events and factors. ICBC submits that there is no foundation for Pemberton's argument that the basic business does not require adequate capitalization. Subsection 47(1)(a) of the *ICAA* provides for the LGIC to issue directions establishing financial targets for the Corporation's capital base. When such a direction is issued its requirements will be taken into consideration by the Corporation in its applications for future rates.

With respect to the allocation of retained earnings, HSBC Canadian Direct ("HSBC") continues to put forth the view that ICBC should attempt to calculate the relative

contribution of major factors resulting in positive net earnings in order to attribute retained earnings between basic and optional. ICBC maintains that such an exercise would not be meaningful and is not material to the Application. The method of allocation for retained earnings for the purposes of allocating investment income, as described in Appendix C, page 34, has been independently reviewed by an external audit firm and an unqualified opinion issued.

As a crown corporation and vehicle of government, the implementation of public policy and political decisions have, in the past, had significant impact on ICBC's financial results, and its retained earnings. To determine whether the impacts of public policy are more appropriately allocated to basic or optional insurance would be controversial, subject to debate and require a review of past policy and political decisions. ICBC submits such a process would not provide meaningful results.

INCORRECT USE OF FINANCIAL INFORMATION

At page 6 of its Submission BCOAPO indicates that ICBC's net income for 2003, without losses on the sale of assets, restructuring costs and tariff impacts would be $85,972,000. BCOAPO's calculation is derived from the Basic Business Statement of Operations but is incorrect since it added the gain on the sale of assets when that gain of $9,121,000 should have been subtracted in the calculation.

Beyond the calculation error, the approach taken by BCOAPO is more fundamentally flawed. BCOAPO's simplistic approach has failed to take into account any year-over-year changes in revenues or costs. Using 2003 to determine 2004 net income is inappropriate as the business changes from year to year, and the external and internal environments are not static. Major components of the determination of net income are the claims incurred costs and prior years' claims adjustments. Claims incurred cost amounts are calculated actuarially based on claims trends, which have been increasing over time and are expected to continue to increase for 2004. The impact will be higher claims incurred costs for 2004 as compared to 2003. 2003 has some prior years' claims adjustments whereas the assumption for the 2004 forecast is that there will be no prior years' claims adjustments. Factors of this type were not considered in the BCOAPO approach. There are other differences in costs between 2003 and 2004 that were discussed in the supplemental response to information

requests dated October 1, 2003. These differences were also not considered in the BCOAPO approach.

Another key variable between years is investment income that is based on asset mix and economic assumptions. Again, changes to investment income between 2003 and 2004 were not considered in the BCOAPO approach.

The statement of operations for 2004 (see Application page 4-3) takes all of the appropriate factors into account and includes the requested premium increase of 1.3%, resulting in a net income of $41 million. ICBC submits its forecast for 2004 provides the Commission with the best information, after taking into account the expected changes in the basic business.

At page 1 of its Submission Pemberton says that 2002 showed a $153 million profit for basic and at page 14 it says that basic coverage earned approximately a 10% profit margin on every policy issued. Those statements appear to be based on Pemberton's Exhibit 4. In that Exhibit Pemberton has arbitrarily crossed out restructuring costs and non-insurance costs. There is no rational basis for doing so. Pursuant to clauses 2(2)(a)(ii) and (iii) of *Special Direction IC1* the non-insurance costs must be taken into account in the calculation of the setting of basic rates to be consistent with the net income target of $36 million established by the *Special Direction*. Contrary to the suggestions of Pemberton that there was a profit of $153 million in 2002, ICBC had an underwriting loss of $68.7 million on basic business in 2002 (as shown on the Basic Business Statement of Operations for 2002); so premiums were not even covering insurance costs. Investment income was sufficient to cover the shortfall, the non-insurance costs and to produce net income. For 2003 and 2004 claims incurred costs continue to increase, while the basic premium increase for 2003 and that proposed for 2004 are minimal. At pages 1 and 2 Pemberton advocates a 10% reduction in basic rates. The only basis provided by Pemberton for a 10% reduction is the 10% profit margin derived from Pemberton's Exhibit 4, which has no foundation in the facts. Contrary to Pemberton's 10% reduction, the actuarially required increase (which as noted on page 2 of this document, Pemberton appears to support) is 3%.

PROGRAM BENEFITS

At page 2 of its Submission HSBC suggests that ICBC has failed to take into account benefits from new programs and changes to the Graduated Licensing program. The benefits of such programs are primarily the reduction in the number or severity of claims. The actuarial indicated rate level change (3%) in the Application is based upon expected claims costs associated with the policies being sold in 2004. As a precursor to determining expected claims costs, frequency and severity trends are estimated through econometric models, step-wise regressions and exponential regressions. This process allows for the testing and identification of a number of economic, weather-related and program variables that may have a statistically significant influence on historical and future claims trends. Therefore, the effects of various road safety programs and the enhanced graduated licensing will be reflected in the frequency and severity trends when they have statistical significance. With respect to the graduated licensing program, it has been identified as a valid explanatory variable in some of the trend models (as shown in Appendix I, Exhibit B.1 and B.2), but always with a lag of at least 18 months. In other words, the graduated licensing program did not statistically influence overall claims trends until at least 18 months after implementation. An 18 month lag for the effects of enhancement of the program would result in the benefits applicable to policy year 2004 being minimal. ICBC seeks to have in place a smooth and stable rate environment, which the actuarial indicated rate level change reflects through claims trends by utilizing longer-term historical information where appropriate.

CONTROLLABLE EXPENSES

As stated in its initial Submission, ICBC has made significant changes to streamline processes, eliminate business functions and reduce operating costs over the two year period to the end of 2002. Staffing levels were reduced by approximately 1,400 FTEs or 21%, savings were realized in facilities and vehicle services costs, and discretionary spending was reduced by 26% over two years. Since then, overall costs and staffing levels have been maintained, and only increases that are non-controllable and identifiable have been included in 2004 costs.

HSBC suggests at page 2 of its Submission that for 2004 ICBC's staffing levels will rise marginally and controllable expenses will increase. ICBC maintains that staffing levels will remain relatively flat between 2003 and 2004, and the Corporation is committed to maintaining the 2002 base for controllable costs into 2003 and 2004. Any increases are attributable to identifiable and justifiable cost changes (see the Supplementary response issued October 1, 2003 and the response to BCUC Information Request 1.6.1.4).

Reference is also made by HSBC on page 2 to non-insurance services expenses, stating that these expenses have "... increased from $48.9 million in 1997 to an adjusted $99m in 2002". HSBC has inaccurately portrayed the recovery amount of $48.9 million as being the complete costs of operating non-insurance services, which have actually decreased in total from 2000 to 2002, similar to overall operating costs. HSBC is also attempting to compare non-insurance expenditures during 1997 and 1998 when ICBC received a partial recovery of costs from government to years after 1998, when ICBC was absorbing the full costs of operating non-insurance services. This is an inappropriate comparison.

On page 8 of its Submission Pemberton makes reference to compensation paid to staff and employees as being one of the most significant costs in running an insurance organization. While the vast majority of costs associated with running an insurance company are claims costs, ICBC agrees that the majority of its controllable operating costs consist of compensation expenses. The significant reductions experienced between 2000 and 2002 resulted from a reduction in staffing in various areas. In addition, ICBC has sought to better align staff to the needs of the customer. This included performance pay for management as part of the move away from an entitlement culture to a performance culture. In conjunction with this move, vacation time and post retirement benefits were reduced, and 16 time off days were eliminated for management and confidential employees. This policy change was fundamental in aligning staff to the corporate goals and objectives and in meeting performance targets. While a greater portion of management compensation is at risk, since it is only paid if performance targets are met, there is greater incentive to ensure the company is run efficiently for the benefit of the customers and that they receive the most value for what they pay. At page 2 of its October 17 letter the OPEIU asserts that compensation increases to management are unacceptable.

ICBC does not agree. ICBC's overall compensation costs have declined by 4.3% from 2000, and management and executive compensation in total has declined by 8.4%, while bargaining unit staff total compensation has declined by 3.1% (See the response to the OPEIU dated October 10, 2003).

ADEQUACY OF EVIDENCE

The BCOAPO and other Intervenors commented on the adequacy of the evidence. ICBC submits the material before the Commission fully supports the request for 1.3% increase in basic rates. Extensive actuarial and other evidence has been provided in support of the rate application.

Since the requirement to segregate ICBC's financial information between basic and optional is a new requirement for ICBC, historical data divided between the basic and optional businesses is not available. The development of the financial allocation methodology took considerable time and effort, and only began in early 2003. The independent assessment by the external audit firm was completed in August 2003, with the issuance of its unqualified opinion.

The process established for the 2004 Revenue Requirement Application is intended to allow the Commission to render a decision by mid November. Changes to the *ICAA*, which established BCUC as the regulator for ICBC, were not enacted until July, the associated regulations deposited August 12, and ICBC's Application was prepared in August and submitted on August 29, 2003. A workshop was held in early September and the written hearing process commenced in mid September. Given the timeframe for the process, undertaking new analyses or research was not possible for responses to information requests.

On page 1 of its Submission HSBC suggests that 2002 was not an appropriate starting point and that some of the information in ICBC's Application had no relevance. ICBC does not agree that information it provided is not relevant. ICBC used 2002 as a base because it was the completion of ICBC's cost reduction initiative, and it is the last year for which audited financial statements are available. Using an earlier or longer period would have resulted in a higher cost base, as the Corporation's costs were at a low level in 2002. As set out in ICBC's Annual Report, page 1, controllable costs for the Corporation were $624.6 million in 1999, $635.5

million in 2000 and decreased to $566.3 million in 2001 and $461.7 million in 2002. Use of a prior year, or period of years, would have resulted in higher costs as a starting base. ICBC submits 2002 is an appropriate starting point.

HSBC at page 1 refers to changes in premium acquisition costs as a basis for questioning the use of 2002 data. Adjustments for deferred premium acquisition costs ("DPAC") are standard in the insurance industry. These costs were explained in the response to BCUC information request 1.5.1.6 and are further discussed in notes 2 and 9 (pages 53 and 60) of the Corporation's Annual Report (Appendix A of the Application). The existence of the DPAC adjustment is no reason to reject the use of 2002 as the appropriate starting point.

On page 7 of its Submission BCOAPO refers to BCOAPO.1.1 as an example of ICBC not providing direct answers. The question referred to a recent study by the Consumers' Association of Canada and requested that ICBC comment on its own premium rates relative to the remaining three Canadian provinces with public automobile insurance, and the factors accounting for the difference. The response discussed the differences in the insurance product and the drivers of costs between a tort environment and no-fault environment. A comprehensive analysis was not possible given the timeframes, nor did ICBC believe this was relevant to the approval of 2004 rates since rate differences are largely due to different insurance products, and the definition of the basic product is a matter of government policy.

On pages 5 and 6 BCOAPO refers to ICBC's response to BCUC.1.1.4.3 and 1.6.4.2 as inadequate responses. BCUC 1.1.4.3 asked for updated information reflecting the most recent operating results for 2003. The Application was prepared in August 2003 using the most current financial information. The information requests followed shortly thereafter. At the time of responding to the requests, there was no more current financial information available than that used to prepare the Application, and the available information was not broken down in the manner requested in BCUC 1.6.4.2. This was further addressed in the Supplementary response to information requests of October 1, 2003. There was nothing inadequate about the responses to the questions.

In the second to last paragraph on page 5 of its Submission BCOAPO refers to vehicle upgrades and premium forecasts. On that page it also refers to BCUC.1.2.4.1 and BCUC.1.2.4.3 as lacking detailed information of ICBC's vehicle

premium forecast. It appears that BCOAPO does not understand that vehicle type is not used by ICBC in its determination of basic insurance premiums. Since vehicle type does not play a part in basic insurance premiums, vehicle upgrades will have no effect on premiums for basic insurance (as explained in the response to BCOAPO 1.11b and 1.11c). Basic insurance is rated by how the vehicle is used and in what territory it is driven, with a discount or surcharge applied based on the driving and claims experience of the principle operator and registered owner. The make, model and model year of a vehicle is not used in calculating basic premiums. Those factors would affect premiums for collision and comprehensive coverages, which are included in ICBC's optional business but which is not the subject of this Application. Since the Submission of BCOAPO refers to the Manitoba Public Insurance Corporation ("MPIC"), it should be noted that vehicle upgrades is a factor in MPIC's forecasts of premiums since the mandatory product in Manitoba includes collision and comprehensive coverages.

At page 1 the IBC repeats its comment about the trend analysis it had requested. As stated at pages 13 and 14 of the initial Submission, IBC can make a good and reasonable determination of historical and future trends with the data provided; a complete duplication of ICBC's trend analysis is not required.

At page 15 Pemberton said that it became evident during the information request process that ICBC may not be receiving good value for monies expended. Pemberton did not identify the item(s) to which it was referring. ICBC believes that as a result of its initiatives to reduce costs it receives good value for its expenditures.

FINANCIAL ALLOCATION

A number of Intervenors commented on the division of costs between basic and optional insurance. In determining the revenues and costs associated with the basic business for purposes of rate setting, a detailed review was undertaken to develop a financial allocation methodology (Appendix C in the Application). This methodology was independently reviewed and an unqualified opinion issued by PricewaterhouseCoopers, an independent audit firm as to its appropriateness (Appendix D, Auditors' Report). Application of the methodology has resulted in an

appropriate allocation of the revenue and costs related to the basic and optional businesses.

HSBC took issue with 2002 as the starting point for the allocation study and complained about the lack of historical allocation information. The changes to the allocation methodology suggested by HSBC on page 3 of its Submission, such as moving calls to the call centre environment and the introduction of Express Glass happened prior to 2002 and are thus reflected in the allocation used in the Application; the study took into account the most recent work processes as the study was conducted in 2003. As explained in ICBC's initial Submission at page 10, in the past an allocation of revenues and costs of the type now required was not necessary, and therefore was not undertaken as ICBC has always been run as an integrated business.

HSBC questioned whether changes in service were introduced to service basic claims or to enhance ICBC's position in competitive markets. Business changes are introduced for the benefit of customers by providing better service or convenience or lower costs; business changes are not simply to benefit the optional business. The pro rata approach to allocation used by ICBC is the best method for cost allocation where a business change affects both basic and optional businesses as it does not bias the allocation to either basic or optional.

At page 3 HSBC says some costs directly attributed require more examination; but HSBC fails to identify any such costs. A detailed review was undertaken of revenues and costs, with the focus being on underlying revenue and cost drivers. ICBC submits that sufficient examination has occurred.

At page 11 of its Submission Pemberton expresses the view that a significant part of the cost of claims lies with the first party insurer and that more costs should be transferred to optional. Pemberton goes on to suggest that "additional or incremental cost" should be used in the allocation of costs. A suggestion that an incremental approach would allocate more costs to optional business is faulty, because there are many more costs that would have as their primary source basic insurance. Since the basic coverage is mandatory for all vehicle owners, the incremental approach would start with the full infrastructure costs being allocated to the basic business. This would cause a significant shifting of costs to the basic business. ICBC believes the

pro rata approach to be the better approach for the allocation costs to basic and optional insurance.

In footnote 10 of its Submission HSBC refers to page 6 of its October 3 letter and says that its specific concerns were not dealt with in ICBC's initial Submission. The concerns on page 6 of the October 3 letter related to road safety costs, Autoplan Service expenses, Shared Services costs and expenses associated with the handling of claims. Road safety costs were addressed at page 2 of the initial Submission with the reference to clause 2(2)(a)(i) of *Special Direction IC1*. Autoplan Services expenses were discussed in the response to BCUC 1A.9.11.1. Shared Services costs were addressed in the allocation study and directly attributed where possible. On page 6 of its October 3 letter HSBC suggested that costs associated with the handling of claims be dealt with on an incremental basis with the primary recipient of costs being the optional business. As explained at page 11 of the initial Submission, the use of an incremental approach will skew results and is not appropriate. As noted above, if an incremental approach were used the basic business would be the primary recipient of costs as it is the mandatory coverage for all policyholders.

At page 12 Pemberton expressed the view that non-insurance costs should not be allocated and should come from ICBC as an entity. While that may be the view of Pemberton, it fails to take into account the provisions of clauses 2(2)(a)(ii) and (iii) of *Special Direction IC1* where the non-insurance costs are directed to be covered by basic insurance. If government directed all insurance companies to cover a cost (such as increases to the premium tax), then ICBC would spread the costs between basic and optional insurance proportionately. This would also apply if the government directed all insurance companies to supply firewood, to use Pemberton's example. The non-insurance costs are not being covered by all automobile insurance companies and therefore, as directed by the *Special Direction*, the basic insurance business which affects all policyholders in the province is responsible for these costs.

At page 13 Pemberton suggests inclusion of the cost of a government guarantee, income taxes and a return on equity (ROE) of 17% in the costs associated with ICBC's optional automobile insurance. In responding to that argument it must first be noted that Pemberton's suggestion has nothing whatsoever to do with basic

insurance, and represents nothing more than an attempt to increase the price of ICBC's optional coverages; it is clearly in the interests of competitors to force ICBC's optional premiums to rise.

Pemberton acknowledges that the guarantee, income taxes and an ROE of 17% are all "notional" costs; and according to Pemberton the inclusion of these notional costs should cause ICBC's optional premiums to increase 14%. While ICBC submits it would be inappropriate to include in the determination of premiums, costs that are notional, if those types of costs were included for optional coverages, they should also be included as costs for basic insurance coverage, which would require increases in basic premiums.

In Exhibit 3 Pemberton provides financial models that make use of a rate increase of 14% for optional coverages and various retention rates. In Exhibit 3 Pemberton adjusts 2002 data for the three notional costs discussed above and also for an unexplained item described as "Cost of Data". Exhibit 3, and its results, are no more valid than the inclusion of notional costs in the calculation of optional premiums. Moreover, as noted above, Exhibit 3 and its underlying assumptions have nothing whatsoever to do with basic insurance.

ICBC is compelled to respond to Pemberton's improper assertion (at page 15) that "ICBC has clearly established a dominant market position in the Optional Coverages division, an unequivocal result of subsidized pricing." This Intervenor's submission is full of references to the history of ICBC, but by virtue of that quote it is evident that it has no factual understanding of ICBC. ICBC is the dominant writer of optional insurance due to the original structure, which established ICBC as the sole provider of both basic and optional coverages. Many private sector companies have entered the B.C. market unobstructed by limitations such as no use of age, sex and marital status for rating purposes (a policy to which ICBC has adhered). The private sector is growing every year in B.C. and currently writes well in excess of $100 million, and disproportionately in selected territories and coverages. ICBC's audited financial statements (Appendices C and D of the Application) confirm that ICBC made a profit in optional insurance in 2002, hardly validation for the assertion of cross-subsidization.

RECOMMENDATIONS

It is evident from the Submission of IBC that it has been seeking in this proceeding, and will be seeking in the next ICBC proceeding, competitive information. IBC refers to its past Freedom of Information requests where competitive information was not supplied by ICBC, and IBC makes it clear that it will now use BCUC proceedings to attempt to obtain such information. ICBC submits that in future proceedings the Commission will have to ensure that its proceedings are not used as a means for private insurers and their representative, the Insurance Bureau of Canada, to obtain proprietary, competitive information. The issue of confidentiality of competitive and proprietary information is not unique to ICBC as many other companies who fall under the regulatory purview of BCUC have such data. The Commission must not become a vehicle for the transfer of competitive or proprietary information from companies it regulates to others who wish to make use of that information.

At page 7 of its Submission BCOAPO has made 10 recommendations. The responses of ICBC are set out below.

1. Detailed evidence to support basic business statement of operations.

   ICBC has reduced costs and is maintaining this lower cost level by tight monitoring of expenditures for the benefit of customers. Since the BCUC process is new for the organization, ICBC will continue to improve the level of detailed information provided.

2. Historical comparisons between forecast and actual for basic business.

   ICBC has established 2002 as a baseline, as a result of the cost reduction measures taken. Going forward, ICBC will continue to provide longer term information along with current information.

3. Long term forecasts of basic results are required.

   ICBC supports using the actuarial process for exactly this reason, to be able to minimize rate shock for policyholders and provide more stable rate changes.

4. Comprehensive details of allocation methodology.

   ICBC submits that it has used a detailed approach as described in the Financial Allocation Report (Appendix C to the Application).

5. Address retained earnings targets required for rate stabilization.

Subsection 47(1)(a) of the *ICAA* provides for directions from the LGIC establishing targets for the Corporation's capital base. When issued, such targets will be taken into account by ICBC.

6. Comparable level of detail as MPIC.

   While ICBC and others can always benefit from comparable knowledge and expertise, it will be for the BCUC to establish what is appropriate for its proceedings. The objective should be the provision of relevant information, not the unnecessary provision of a vast amount of information that may not be useful.

7. Study on benefits and costs of shift to no-fault.

   The Allen report done for the British Columbia government and dated December 19, 1996, said "there is a potential to reduce product costs by 15-25% moving from tort to no-fault". A change to no-fault is a matter for the government. ICBC believes it would be imprudent to invest in such research if it is not requested by the government.

8. Future applications should address rate design.

   Addressing rate design changes adds time and cost to the regulatory process and was not appropriate for this first revenue requirement application of ICBC. The Corporation will address rate design in future proceedings, but implementation of changes must be undertaken in a manner that avoids rate shock and other significant impacts on customers.

9. Benchmarking of performance against other public insurance companies.

   ICBC has no special status which permits access to data of other provincial insurers. Additionally, the laws, products, geographic conditions, size of the customer base and distribution channel operating models are materially different from province to province. ICBC does compare itself to different insurers through an external independent report such as AM Best (as evidenced in the Annual Report); however, there are differences in the products and environments that also need to be taken into account when making such comparisons.

10. More forthcoming in responding to information requests.

ICBC has provided, and in future will provide, information relevant to the review of basic rates. As ICBC becomes more familiar with the requirements of a regulatory review by the Commission, the Corporation will further endeavour to address the legitimate expectations of Intervenors and to assist the Commission in fulfilling its mandate of setting just and reasonable rates.

CONCLUSION

ICBC submits its request for a 1.3% increase is reasonable and has been justified in the material before the Commission. The increase sought by the Corporation is required to meet its legislated requirement for 2004, as set out in *Special Direction IC1*. The requested rate increase relates to increases in two uncontrollable expenses. As discussed above, in the Intervenors' Submissions little issue is taken with those cost increases.

This first revenue requirement application has been a new experience for the Corporation. The Commission's decision recognizes the interests of the Corporation and policyholders, while meeting the requirements of the legislation and *Special Direction IC1*. ICBC believes its application recognizes those interests while meeting the statutory requirements. The Corporation now awaits its first Commission Decision.

All of which is respectfully submitted,

Donnie Wing
Vice President, Investments & Corporate Development
October 24, 2003